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Reflections on the pro-union and pro -independence contributions to the Fraser Economic Commentary and on proposals for enhanced devolution of economic powers to Scotland

Andrew Goudie¹

Abstract

This second paper briefly reflects on two specific contributions to the debate by representatives of each of the Referendum campaigns. They appeared in the FAI Economic Commentary, March 2014 Vol 37 (3): the first written by John Swinney, MSP, and the second by Professor Jim Gallagher. In particular, the paper considers the extent to which these two contributions address the challenges presented by the *Six Tests*, set out in Goudie (2013), with their emphasis on how effectively different constitutional propositions might stand up to the key economic challenges over the longer term. To date, the independence agenda has been articulated to a far greater degree than the agenda that might drive enhanced devolution within the union. The paper, therefore, turns to the propositions of enhanced devolution and some of the crucial issues that must be more systematically addressed in the event that this form of constitutional transformation is preferred in the Referendum.

I Introduction.

In the Volume 37 (3), March 2014 edition of the Fraser of Allander Economic Commentary, two contributors, John Swinney, MSP and Professor Jim Gallagher², provided considerable insight into the economic thinking that underpins the pro-independence and pro-union campaigns. Both focussed on articulating the economic benefits that their constitutional preference would generate and each provided some analysis of how their preferred economic system would stand up to scrutiny when tested against the *Six Tests*³.

This paper briefly reflects on these two contributions and, in particular, looks at them from the perspective of the insight they bring to the key economic questions set out in the first paper in this Policy Section, *Reflections on the key economic questions in the Scottish Independence Referendum*, and especially from the perspective of the *Six Tests*, first set out in Goudie (2013), with its emphasis on how different constitutional propositions might manage the key challenges that any economic system must

¹ Professor Andrew Goudie is currently Visiting Professor and Special Adviser to the Principal at the University of Strathclyde in Glasgow. He is the former Chief Economic Adviser to the Scottish Government and a former Chief Economist at the UK Department for International Development. He was a Research Fellow of Queens' College, University of Cambridge. He is a Fellow of the Royal Society of Edinburgh.

² The articles were in the Fraser of Allander Economic Commentary, volume 37(3), March 2014, Fraser of Allander, University of Strathclyde. The first was by Professor Jim Gallagher, *The Economic Case for Union*; the second was by John Swinney, MSP, *The Economic Case for an Independent Scotland*.

³ See the discussion in the preceding paper in this Volume, *Reflections on the key economic questions in the Scottish Independence Referendum*, Andrew Goudie, and Chapter 2 of Goudie (2013).

handle. To date, the independence agenda has been articulated to a far greater degree than the agenda that might drive enhanced devolution within the union. The paper therefore turns to the propositions of enhanced devolution and some of the crucial issues that must be more systematically addressed in the event that this form of constitutional transformation is preferred in the Referendum.

II The pro-independence and pro-union contributions to the Fraser Economic Commentary.

The two articles referred to above illustrate the nature of the economic debate over recent months and some broad, high-level reflections on the papers are offered here:

- Both campaigns have tended to focus on the perceived benefits of the constitutional forms for which they have a pre-determined preference and strongly assert their conclusions, rather than open up debate around the undoubted risks and uncertainties of their preferred option. Similarly, each camp has emphasised the perceived costs and dangers of the competing vision, rather than risk appearing to concede anything with respect to the potential benefits. This very extreme form of political risk-aversion is perhaps not surprising, given the enormity of the stakes and the importance of the outcome, but it is not conducive to advancing an intensive analysis and debate of the choices.
- Neither campaign has found it easy to provide the hard evidence that many have sought from the debate. To a considerable extent, this is no criticism of the protagonists, nor of the academic and business communities: the evidence is simply not available in many instances, certainly not with the precision and direct relevance that purity would require. More qualitative and more theoretical argument necessarily entails greater subjectivity and, therefore, less obvious clarity and consensus around the conclusion.

The pro-union contribution to the Commentary.

- The pro-union campaign has faced severe criticism of its negativity and its failure to set out the positive benefits of the union. Much of this has been true, with the political interaction heavily focussed on the risks of independence, often to the exclusion of the risks of the union. Similarly, there has been little acknowledgement of the potential benefits that greater autonomy might bring or indeed of the benefits of the continued union. The Gallagher paper and an earlier presentation by the pro-union leadership⁴ do, in fact, attempt to counter this. Both do discuss the benefits of the UK, as they see them, focussing heavily on the perceived gains in four areas: free trade, risk management at the UK level, the established monetary and banking union, and the fiscal union.

Many commentators, nonetheless, regard the pro-union camp's weaknesses in projecting a positive, ambitious vision - for a new dynamic phase of union that does embrace all regions of the UK - as an obvious shortcoming. Indeed, in Gallagher's article, the focus switches firmly towards the reasons why the currently advocated model of independence would be a poor choice in the pro-union campaign's view. The article asserts powerfully that the independence model will fail each of the *Six Tests* set out in the preceding paper in this Commentary, but provides little on the

⁴ *Darling (July 2013).*

mechanisms through which such risks could be broadly managed in a small, independent economy. Experience in other small economies across the globe broadly suggests that short term stability and longer term competitiveness - and indeed unanticipated shocks - *can* be managed. That is, these economies do find mechanisms through which the *Six Tests* are satisfied, despite some important challenges and perhaps with some costs attached.

Interestingly, in the same article, the proposition for a continuing union is not analysed explicitly within the *Six Tests* framework.

- Little is said in the article to establish why the larger UK Union would be better placed to provide shorter term stability and to withstand the kind of external shocks that have recently hit the global economy compared to a small independent state. In particular, there has been little attempt to counter the pro-independence camp's argument that failures at the UK level in fiscal, monetary and banking policy contributed to the financial crisis and to the subsequent recession, through poor oversight and analysis, regulation and policy design. There are obvious internal constraints within the pro-union campaign that make this a difficult area, since the Labour and Conservative Parties would never agree on a riposte, given their fiercely opposing views throughout this period. Perhaps more importantly, there is little attempt to differentiate between the policy implications of this period that carry little constitutional relevance, from the relevance of this period for future constitutional arrangements.
- The pro-union article also places a heavy emphasis on the transitional period. As was noted above - and as is captured explicitly in the fifth *Test*, although not with the priority accorded in Gallagher's article - this is an important argument and both the relative size of transitional costs and the impact, intensity and time period of the transition are, of course, legitimate questions to raise.

The pro-independence contribution to the Commentary.

- The pro-independence campaign unsurprisingly articulates a powerful and ambitious vision. Importantly, it does not only emphasise the legitimacy and value of self-determination irrespective of the outcomes that independence might bring. The achievement of self-government is not sufficient: the assertion that independence will bring greater economic benefit is of considerable significance. As noted above, it is unreasonable to expect pro-independence advocates to *prove* this case, just as it would be unreasonable to expect pro-unionists to *prove* that the union will bring greater prosperity.

However, having strongly and consistently asserted that independence models will be superior, the article is somewhat reticent on *how* this would be achieved. Of course, any future context is unknown, but the generalities around using (apparently unconstrained) tax and welfare policy, and around "*establishing industrial strategy focussed on diversifying.... manufacturing, innovation and productivity*" give little insight into how – and why - future outcomes under an independence model would differ from a past in which UK policy in these areas has typically struggled. The high level objectives are probably widely shared, but it is unclear what new opportunities would arise to make the difference. Similarly, "*the use of tax and allowances to (promote) R&D*" reflects an admirable

policy direction but, as in many areas, the mechanisms through which the past experiences are significantly surpassed are unclear.

Other documents⁵, however, do provide more insight into how economic policy might be conducted within an independence model to stimulate economic growth. They, nonetheless, say little about the limitations and constraints upon policy, the trade-offs and choices that would need to be made and the challenges of prioritisation and affordability. Nor do they provide much insight into why the newly available levers would be more effectively deployed and secure superior outcomes than in the past.

Moreover, there is a familiar underlying assumption that fiscal policy would be subject to no external constraint in a formal sterling monetary union, but, so far, this has not convinced the UK or EU authorities, or indeed many of the more objective observers of the campaign. Post-Referendum, with a yes vote, this would be the key challenge in any negotiation.

- The pro-independence campaign unsurprisingly asserts that the *"vast majority of decisions that influence Scotland's economic structure, rate of growth and levels of equality are taken outwith Scotland"*. This is undoubtedly an overstatement. Certainly, the macroeconomic decisions reside currently in Westminster, but the critical role of microeconomic policy and the effective implementation of supply-side policy are widely recognised throughout the world as crucial in building healthy and high-quality human capital, in particular, and the other key economic infrastructure that underpins economic development. While some microeconomic powers are indeed reserved, many of the prime micro powers already sit in Holyrood. The primary question is whether the currently reserved macro and reserved micro powers could add substantively to the overall policy stance by being brought together under an independent Scotland ?
- As with the pro-union article, little is said of the mechanisms through which economic stability and the absorption of external shocks would be achieved; this is the crux of two of the *Tests*. There are strong assertions about the value of new economic powers that would provide the levers for securing these objectives, but the risks and uncertainties that might be anticipated with an independence model and the likely constraints that would impact on the policy decision-making process are not considered. The specific form of independence is a critical area, defining as it does the scope to pursue policy that is not limited by formal agreements that might operate within a monetary union, or by choice in order not to provoke a retaliatory response from competitors.
- Ultimately, the critical challenge is this: *can policy be defined in a sufficiently distinctive manner to provide an independent Scotland with the comparative advantage that would allow it to markedly accelerate the nation's economic development ?*

⁵ Scottish Government (2013), for example, sets out a more comprehensive picture of how new economic levers within an independence model might be deployed to facilitate accelerated economic growth. The chapters on competitiveness and reindustrialisation, and on innovation provide more detail on specific potential opportunities.

III The Enhanced Devolution Option.

The advocates of the Union have broadly offered increased economic powers for Scotland in the event of the Referendum rejecting the independence option. Often without great conviction and typically in a somewhat incoherent and unstructured manner, the basic proposition has been to convene a Commission or other gathering post-Referendum in order to define a set of new powers.

This approach has been challenged on several fronts. Firstly, there is no specificity at this time of what *enhanced powers* might in fact constitute and on what timescale such powers might be transferred⁶. Notwithstanding the recent flurry of proposals that the three main UK Parties have produced, the absence of any sustained and coherent discussion of what economic powers might be considered for transfer to Holyrood post-Referendum leaves the Scottish electorate little the wiser of what form this alternative constitutional proposition might take.

Secondly, there is a major credibility question. Whether any promises – particularly when they are ill-defined – would ever see the light of day is strongly contested, with the pro-independence group citing the 1979 experience in which Alec Douglas-Home made promises that were subsequently broken. While this event raises a legitimate concern, not least in a country in which the trust for the political classes is exceptionally low, it has been observed by some that it is not clear that this specific event and the role of these particular individuals has any great relevance 35 years later. Nonetheless, how credibility and trust is secured is a massive challenge for the pro-union group.^{7, 8}

Not least must be the concern that, post-Referendum, the UK is simply distracted by other priorities at that time or indeed exhausted by the Referendum campaign. In these circumstances, there might be little immediate appetite, both at the political and civic level, for a major initiative to drive through the significant work required for the formulation of coherent programmes to transfer more powers.

Thirdly, the rationale for new powers has, in part, been founded on various perceptions of the current lack of accountability over expenditure and revenue-raising at the Scotland level and therefore the value of bringing the powers closer to the electorate. This view has largely gone unchallenged. However, to the extent that the rationale also rests – and certainly should rest – on the economic value of having a greater array of economic levers to deploy in response to the specific context of the Scottish national economy, the arguments are far from compelling. Indeed, little has been said about the manner in which

⁶ Indeed, in a recent BBC interview, David Cameron said he could not guarantee that legislation for more powers would be included in the first Queen's speech after the next general election, if he is in government. See BBC (2014).

⁷ The oft-quoted speech by Alec Douglas-Home appealed to Scots to reject devolution with the promise of "something better" at a later stage. This suspicion was encouraged by the broader views that were held with respect to devolution. In her memoirs, Margaret Thatcher notes that, with the rejection of greater devolution in the 1979 vote, "Although I had not publicly campaigned for a 'No' vote in the referenda in Scotland and Wales, that was the result I wanted. For the moment, devolution was dead: I did not mourn it". Thatcher (1995).

⁸ Interestingly, it is not only the pro-independence group that has challenged the credibility of the promise of greater devolution. In the House of Commons debate on Scotland's Future in the UK (25 November 2009), Alistair Carmichael, MP, the current Secretary of State for Scotland, then in opposition to the Labour Government, observed: "I listened to the hon. Member for Dumfriesshire, Clydesdale and Tweeddale (David Mundell) speaking about producing another White Paper the other side of a general election, and I could almost hear the ghost of Sir Alec Douglas-Home speaking prior to the 1979 referendum. He promised that we would get something better from the Conservatives, but they betrayed us after the 1979 election, and they would betray us again tomorrow given half a chance which, fortunately, they are unlikely to get."

<http://www.publications.parliament.uk/pa/cm200910/cmhansrd/cm091125/debtext/91125-0007.htm>

new powers would be deployed and about the underlying evidence and justification for believing these powers would be effective in achieving the objectives.

While enhanced devolution does not appear as an option on the ballot paper, it is arguably a critical element in the outcome of the Referendum. As various survey and polling evidence have suggested, there is very considerable support for enhanced economic powers in Scotland and the effect on voting behaviour of the various political promises and claims in this regard would, therefore, be expected to be highly significant. The debate in 2012 around the precise form of question(s) to be asked in the Referendum demonstrated the key nature of this point. Many have suggested that, on the basis of the polling evidence, a set of constitutional options that incorporated enhanced devolution within the UK would have won strong support.

One good example of this point is reflected in the work of Professor John Curtice⁹ of the University of Strathclyde. In early 2014, he found that 31% said that the Scottish Parliament should make all decisions for Scotland (broadly the independence proposition); 32% said that the Scottish Parliament should be responsible for everything apart from defence and foreign affairs (broadly the 'devo max' proposition¹⁰); 25% said that they were happy with the *status quo* (with taxation and welfare benefits still primarily Westminster's responsibility); while a further 8% reckon that all decisions for Scotland should be made by the UK government.¹¹

For differing strategic reasons, the political view converged on a simple yes/no question, but, even within this decision-making framework, the potential impact of the enhanced powers option on the Referendum still remains huge. Hence, it is surprising that the pro-union group has managed this issue so poorly and in such an incoherent manner. The inability to offer a unified view on what enhanced powers might constitute is arguably one sign of this, with the Scottish Labour Party, Scottish Liberal Democrat Party and Scottish Conservative Party all producing their own documents.^{12, 13, 14} Interestingly, there has been an explicit statement that no cross-party, agreed announcement on the specifics of further devolution for Scotland would be made prior to the Referendum.¹⁵

⁹ *What Does Scotland Think About More Devolution?*, John Curtice (February 2014).

¹⁰ See, for example, the explanation of the various enhanced devolution propositions in Goudie (2013), chapter 1.

¹¹ Curtice (2014) also comments that ... "in short, no single option for Scotland's constitutional future commands the support of more than a third of Scottish voters. That perhaps is one reason why finding a stable constitutional settlement for Scotland has so far proven so difficult". He also notes that.... "however, just looking at people's first preferences underestimates the level of support for more devolution. This year we also asked SSA respondents what their second preference would be. Overall, 42% said that 'devo max' was their second preference. No less than 79% of those whose first preference is independence named 'devo max' as their second choice, as did two-thirds (66%) of those who would prefer to see a continuation of the status quo. That means that overall, nearly three-quarters of all respondents (32% + 42%) said that 'devo max' was their first or second preference."

¹² *Powers for a purpose - Strengthening Accountability and Empowering People*. Scottish Labour, Devolution Commission. March 2014.

¹³ *Federalism: the best future for Scotland. The report of the Home Rule and Community Rule Commission of the Scottish Liberal Democrats*, October 2012; and *CAMPBELL II: The second report of the Home Rule and Community Rule Commission*, Scottish Liberal Democrat Party, March 2014.

¹⁴ *Commission on the Future Governance of Scotland*, Scottish Conservative Party, May 2014.

¹⁵ The pledge made by the leadership of the three Scottish pro-union parties on June 16, 2014 reiterated the common position that additional powers would be transferred to Scotland in the event of a pro-union vote, but there were no further indications of the timescale, the process for bringing this about or the nature of the powers that would transfer.

Underlying this reticence to be explicit are layers of political anxiety, some related to the Referendum itself, as, for example, with the Labour Party's concern not to be seen to endorse a full cross-party deal on devolution before the Referendum in order to prevent its message being undermined by Scottish National Party accusations that it is already in a quasi-coalition with the Conservatives. Other concerns relate to the political positioning before the 2016 UK election and the wish not to blur and complicate the positions the parties will wish to adopt for that key vote. Other factors relate to the inability of individuals to work collegiately between the parties and, indeed, within parties – as with the intra-party fears about the response of backbenchers - deriving from long-standing political differences, animosities and conflicts¹⁶.

Appreciating that political agreement prior to the Referendum is simply impossible amongst the pro-union parties, Sir Menzies Campbell¹⁷ has called for the three pro-union parties to hold a summit within 30 days of the Referendum to agree a broad programme on devolution. While realistic and designed to demonstrate a degree of certainty to counter the “1979” riposte, there remains a serious question of credibility. Can this stance be trusted to indeed deliver, following a *no* result? What might this compromise set of new powers entail? Would it be a convincing set that addresses the preferences of the Scottish electorate and their apparent wish for significantly enhanced accountability?

While there has been no apparent coordination between the pro-union parties in producing their proposals for enhanced devolution, and no attempt to systematically converge on an agreed set of propositions that would provide a desirable degree of clarity to the electorate, some common threads can be seen in their individual plans. These focus around the degree to which income tax powers would be transferred. Whether this disparate set of constitutional alternatives is understood, or is sufficient to persuade the electorate is, of course, the key issue.

Convincing a highly sceptical and suspicious electorate will be a massive task.

Moreover, as noted above, the underlying economic basis for the pro-union propositions that have been advanced has been weak: there has been little clarification of the mechanisms through which Scottish economic performance might be enhanced and the key role that the greater devolution of economic powers to Holyrood might contribute.

Were enhanced devolution to be the basic political choice, the economic thinking around a coherent and economically meaningful set of new powers would need serious development.¹⁸

¹⁶ One recent example has been the highly publicised speech by the former Prime Minister Gordon Brown, MP, which was explicitly hosted under the Scottish Labour Party's separate United with Labour anti-independence banner, rather than the Better Together banner. <http://gordonandsarahbrown.com/2014/04/scotlands-five-big-positives-excerpt-from-gordon-browns-speech-on-tuesday-22nd-april-2014/>

¹⁷ Campbell, Menzies. (2014).

¹⁸ In contrast, it can be argued that the vast array of thinking that has been captured in the Scottish Government's White Paper, the work of the Scottish Government's Fiscal Commission, the sets of analytical documents produced by both the Scottish and UK Governments, by different Parliamentary Committees and by a wide range of academic writers has provided considerable insight into the challenges and opportunities of an independence model.

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